

October 30, 2017

## ITC Limited

### Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme	500.00	[ICRA]A1+ reaffirmed
<b>Total</b>	<b>500.00</b>	

### Rating action

ICRA has re-affirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating assigned to the Rs. 500-crore<sup>1</sup> Commercial Paper Programme of ITC Limited (ITC)<sup>2</sup>.

### Rationale

The reaffirmation of the rating takes into account the dominant position of ITC in the domestic cigarette market despite exposure of the segment to stringent Government policies and regulations. The company has strong cash flows from the business and a highly favourable financial profile characterised by strong return on capital employed (RoCE), conservative gearing and large cash and liquid investments. ITC is also the leading company in the paperboards and specialty packaging segments in India, and has a strong presence in hotels and in the trading of agricultural commodities. The agriculture business continues to support ITC's other businesses in terms of sourcing of the required raw materials. While reaffirming the rating, ICRA has also taken note of the improving performance of ITC's "FMCG Others" business, with the segment breaking even annually since FY2014, notwithstanding the adverse impact of demonetisation and de-stocking in preparation for the GST in recent quarters. Certain quarters, however, remain loss making on account of seasonality. The business will continue to involve high gestation costs and investments in brand building over the medium term. While the company has substantial capital expenditure plans across most of its business divisions, ICRA expects the effect of the same on the capital structure of the company to be low, given the strong cash accruals from its current businesses, which is likely to fund most of the outgo. Further, substantial cash balance and large liquid investments on its books are a strong source of financial flexibility for the company.

### Key rating drivers

#### Credit strengths

- Market leader in cigarettes, with a dominant market share and a strong presence in the almost price-inelastic premium segment** – The cigarette industry in India is dominated by three companies – ITC, Godfrey Phillips India Ltd. (GPI) and VST Industries Ltd. (VST) – which together account for around 99% of the total organised cigarette sales volume in the country. ITC is the market leader, with a market share of over 80%, followed by GPI and VST. The cigarette business remains the mainstay of ITC's revenues and profitability.
- Highly favourable financial profile characterised by high profitability and return on capital employed (RoCE), minimal debt, and large liquid investments** - ITC has demonstrated its ability to maintain the PBIT margin in the business, which stood at a healthy 37% of gross divisional revenues in FY2017, with the trend continuing in the first quarter of FY2018 (provisional) as well. ITC's net profitability also continues to get support from the good returns from its investment portfolio. As on March 31, 2017, on a consolidated basis, ITC had liquid investments of around Rs. 16,740 crore in addition to a cash balance of around Rs. 2,969 crore. The RoCE of the company continues to be healthy and stood at around 37.5% during FY2017.

<sup>1</sup> 100 lakh = 1 crore = 10 million

<sup>2</sup> For complete rating definition please refer to the ICRA website [www.icra.in](http://www.icra.in) or any of the ICRA Rating Publications

- **Increasing diversity in revenue mix; ‘FMCG - Others’ business has been breaking even annually since FY2014** - Although the ‘Other FMCG’ segment was recording losses till Q3 FY2013, primarily on account of expenses towards brand building, especially in the personal-care business, the quantum of the loss declined gradually with the segment breaking even since Q4 FY2013.
- **Largest market share in domestic paperboards, timely investments in capacity expansion paying off**- ITC's Paperboards, Paper and Packaging division is the market leader in India in the paperboards segment, with a wide range of products. Capacity additions across the globe and reduction of import duties under various regional Free Trade Agreements (FTA), especially with ASEAN (zero duty imports under ASEAN Free Trade Agreement), continue to impact the profitability of the sector, although the same remains healthy on an absolute basis. In FY2017, the company had set up India's first bleached chemical thermos mechanical pulp mill at the Bhadrachalam unit. Capacity addition in the value-added paperboard and décor segments is also underway.

#### Credit weaknesses

- **Exposure of the cigarette business, which continues to be the main profit-earning division, to Government policies and regulations** - ITC has been able to maintain its leadership position in the domestic cigarettes industry in a scenario of stringent Government policies and high taxes, including implementation of “The Cigarettes and Other Tobacco Products (Packaging and Labelling) Amendment Rules 2014” from April 1, 2016, which increased the size of the graphic health warning stamped across cigarette packets from 40% to 85%, as well as a considerable increase in cess under the GST structure. Strong brand equity, presence of brands across categories and price points, and an extensive nation-wide distribution network have helped ITC maintain its dominant position in the domestic cigarette market.
- **Performance of the hotel business remains weak, notwithstanding some improvement over the past year** - ITC Hotels chain is the second-largest hotel chain in India, with 98 hotels at 70 locations in India, operating across multiple market segments. The segment registered some improvement in FY2017, recording a growth of 4% driven by improvement in average room rates (ARRs) and higher growth in the Food & Beverage segment.

ICRA notes that the hotel segment is a capital expenditure (capex) intensive segment, with this segment alone accounting for around 16% of the total capex incurred by the company in FY2017.

- **New product and brand launches in the ‘FMCG – Others’ segment likely to continue to impact the performance of the segment, although to a lower extent than in the past** - ITC's “FMCG – Others” business has been the fastest growing segment for ITC in past years and has witnessed many category, brand and product launches. Consequently, the segment involves high gestation costs and investments in brand building, which have impacted divisional profitability. However, the segment has been breaking even annually since FY2014, and is expected to record profits in the current year as well.
- **Large capital expenditure plans; however, given the strong cash flows from the business, effect of the same on the capital structure of the company likely to be low** - Despite significant investments in new business ventures, ITC continues to maintain a very comfortable financial risk profile with negligible gearing and Total Debt / OPBDITA. Going forward also, ITC's internal accruals and liquid assets should be sufficient to fund its capital expenditure requirements, at least over the medium term.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

#### Links to applicable criteria:

[Rating Methodology for Fast Moving Consumer Goods Industry](#)

**About the company:**

Established in 1910, ITC is the largest cigarette manufacturer and seller in the country. ITC operates in five business segments at present — FMCG Cigarettes, FMCG Others, Hotels, Paperboards, Paper and Packaging, and Agri Business.

During April to June, 2017 (provisional), ITC reported a profit after tax (PAT) of Rs. 2,560.50 crore on an operating income of Rs. 9,954.66 crore. During FY2017, the company reported a PAT of Rs. 10,200.90 crore on an operating income of Rs. 40,088.68 crore.

**Key Financial Indicators (Audited)**

	FY2016	FY2017
Operating Income (Rs. crore)	36582.67	40088.68
PAT (Rs. crore)	9326.82*	10200.90
OPBDIT/ OI (%)	37.68%	36.44%
RoCE (%)	37.80%	37.54%
Total Debt/ TNW (times)	0.00	0.00
Total Debt/ OPBDIT (times)	0.00	0.00
Interest coverage (times)	191.64	322.30
NWC/ OI (%)	17%	16%

\*Reported PAT stands at Rs. 9328.37 crore as per ITC's annual report; however, the same has been adjusted for taxation related to previous years, in line with ICRA's standard classifications and estimates

Note: All financial indicators have been calculated as per ICRA's standard classifications and estimates

Source: Annual Reports of Company

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);

NWC: Net Working Capital

**Status of non-cooperation with previous CRA:** Not applicable

**Any other information:** Not applicable

<p><i>Disclosure: A Member of the Board of Directors of ICRA Limited is also an Independent Director on the Board of Directors of ITC Limited. This Director was not involved in any of the discussions and processes related to the Rating of the instrument(s) mentioned herein.</i></p>
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**Rating history for last three years:**
**Table:**

S. No.	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015	
					October 2017	September 2016	September 2015	September 2014	
1	Commercial Paper Programme	Short Term	500.00	Nil	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	

**Complexity level of the rated instrument:**

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

**Annexure-1**  
**Instrument Details**

<b>ISIN No</b>	<b>Instrument</b>	<b>Date of Issuance / Sanction</b>	<b>Coupon Rate</b>	<b>Maturity Date</b>	<b>Amount Rated (Rs. crore)</b>	<b>Current Rating and Outlook</b>
-	Commercial Paper Programme	Not issued	-	-	500.00	[ICRA]A1+

*Source: the company*

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### About ICRA Limited:

**ICRA Limited** was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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